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THESIS

Methods of Providing for Old Age

by

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(B.S. Simmons College 1932)

submitted in partial fulfillment of
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PREFACE

All of us want to get ahead. We desire and hope to thrive, to be prosperous and successful; we dream of the time when we will be able to enjoy our own home or perhaps have a business of our own. We hope to travel or partake of some of the bigger and better things of life.

All of us want to be independent. We want to feel sure that if sickness or accident should overtake us, or if for any other reason we should be unable to work, we shall be able to meet such emergencies without being dependent upon others.

Those of us who have dependents would like to have the satisfaction of knowing that if we should suddenly be taken from them, they would not suffer financial embarrassment.

Finally when we think of growing old, we can visualize only contentment and happiness. The thought of being dependent upon others never enters our minds, especially when we are young and optimistic, because we hope to get ahead and be able to do many things which we cannot afford to do now.

Since it is true that everybody wants to get ahead, why is it that comparatively few succeed financially?

According to reliable statistics only about one person in ten has sufficient property at sixty-five years of age to support himself without working or receiving assistance from others. Why have the other ninety per cent nothing to show for their years of service? Why do so many fail to realize their aspirations?

To answer these questions and to make perfectly sure that I would not be one of the ninety per cent, I decided to make a study of how a young person might best go about providing for a competency.

Owing to the nature of the subject it is impossible for me to give appropriate recognition of the assistance I have received in writing this thesis. As my ancestors were Scotch I naturally have observed and indeed been forced to observe many things with regard to saving that the ordinary person unfortunately would not be burdened with. Many articles have I been passed by my relatives which it was urged I read with care. Thus, though little of the information is original, I cannot directly say from whence it came.

I must, however, particularly make mention of the invaluable assistance given by my father--especially in writing the chapters on savings banks, insurance and securities, in all of which lines it would be hard to find a better informed man.

A conscientious effort has been made to give credit where credit was due. I am quite certain, however, that many ideas have been taken from sources whose origin has been forgotten in the long period of preparation. General acknowledgment of this indebtedness is here given.

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Chapter 1

INTRODUCTION

To provide for old age is a fundamental desire common to most human beings. The motive of accumulating a sum sufficient for old age, or for the protection of their wives and children after their death, prompts most working men as well as business and professional men to work harder and longer during their productive years.

Despite this fundamental desire most humans fail to appreciate the very apt saying that it is not what a person earns but what a person saves that counts.[1.]

Owing to the different conditions existing in various people's lives it is impossible to state any specific sum which a person should set aside regularly. It is one's duty to save all he can economically save, for there is such a thing as extravagance in saving. To save more than one should is meanness, to save less than one should is criminal. True economy stands for the good of all concerned and demands an appropriate saving, neither more nor less.

A sound policy for the beginner demands that only the safest ways of investing money should be indulged in.

[1.] Poor Richard's Almanacs for 1733-1758 -B. Franklin
p. 138

Ample opportunity exists in almost every community of any size for the care of savings. The first investment of most people doubtless takes the form of a savings account in some financial institution, such as a bank, a building association, or Government postal savings system. These and other agencies give opportunity for the accumulation of the "rainy-day" fund. Such a fund is an elementary necessity early in life, and it may well be continued long after considerable accumulations have been gathered.

Next to the small savings account comes life insurance. Just as the "rainy-day" fund provides for current emergencies, life insurance policies give assurance to the beneficiaries that, in the event of the death of the policyholder, they will not be left without funds.

After the saver has accumulated earnings greater than needed to keep his investments in savings accounts and life insurance at the desired levels he should consider the importance of owning a home.

After the three foregoing purposes have been provided for and one still finds earnings accumulating, he should turn to the real estate and bond and stock markets. These fields, perhaps offering more chances for appreciation of principal than any of those previously mentioned,

should be resorted to only after the foregoing investments have been made, and then, owing to the greater risk element in these fields much care should be taken.

I honestly believe that a young person starting out may best provide for a comfortable old age by accumulating his earnings in a systematic manner, and I further believe that the manner above outlined is as safe and practical as any that could be devised; I will therefore discuss with some care the units comprising the above system.

Chapter 2

LIFE INSURANCE

History in the United States.

"There is no argument against the taking of life insurance. It is established that the protection of one's family, or those near to him, is the one thing most to be desired and there is no medium of protection that is better than life insurance. Our government has given close attention to the insurance companies, and they are on so sure a foundation that it is in substance a guaranty method of protection of our people." [1]

Life insurance in the United States was an outgrowth of marine insurance. At first policies were issued covering the risk of capture by pirates, the object being to provide ransom money. Later there were policies covering the risk of death during a voyage, but all these policies were of short duration, usually six months.

The corporate form of insurance organization was introduced in this country in the middle of the nineteenth century. Its outstanding feature was the levying of large sums in the early years of the contract and

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1. Calvin Coolidge - Sound Advice - New York Life Insurance Company

thus providing for the time when the insured's earning power would decrease.

Annuities may be traced back to feudal days. Where a landlord could not readily dispose of his property he would mortgage his income as security and agree to pay a yearly sum to the lender either for a specified number of years or for a lifetime.

The Presbyterian Ministers' Fund was established in Philadelphia in 1759. This fund granted what are now known as survivorship annuities, that is, it paid a yearly sum to the beneficiary during her lifetime.

The Church was the first institution to give serious thought to life insurance in America. The Presbyterian Ministers' Fund established by the Presbyterian Synods of New York and Pennsylvania in 1759 is noteworthy in two respects: as the first corporation organized in America for the purpose of furnishing benefits payable on the occurrence of death, and because it has survived (in a much improved form) to the present time. The benefits of the fund were originally available only to clergymen of the Presbyterian church, but they were later extended to include students of Presbyterian colleges. The society has been remarkably successful because it employs no agents and operates entirely among a section

of the population, which is subject to a very low death rate.

The period immediately preceding and following the Civil War witnessed a considerable growth in the interest displayed in life insurance. The general rise in prices which followed the cutting off of supplies, and the increased demand for commodities of all kinds, resulted in a considerable expansion of trade, and, after the first effects of the war had ceased, the life insurance business shared in this expansion. The increase in the amount of insurance written at this time was, in fact, remarkable.

"During the last three years of the war the rate of annual increase in the amount of life insurance in force was over 30%. With the conclusion of the war the rate of increase became even greater and for several years the business in force increased by over 50% annually." [1]

The twentieth century has witnessed a great liberalization of policy forms. The issuance of life insurance policies to sub-standard risks, which formerly were denied insurance coverage; the introduction of disability and double indemnity benefits in life insurance policies, the development of mass insurance coverage for groups of employees, the reduction of premium rates and the

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1. "Life Insurance" -- MacLean -- p.435

declaration of increased dividends to stockholders and policyholders, are all identified with the progress of the present century. As a result of these improvements the growth of life insurance has been phenomenal. Whereas at the end of the nineteenth century the total life insurance in force in this country was about six and one-third billions of dollars, at the end of the year 1933 was one hundred billions of dollars.

This latter sum was represented by one hundred and fourteen million policies. Allowing for the fact that many individuals are insured under more than one policy, it would still appear that there is hardly a family in the country without an insurance policy on the life of one or more of its members.

By way of comparison, it should be noted that the one hundred billion dollars worth of life insurance in force in the United States is more than double that outstanding in all other countries of the world combined, although the United States has only one-sixteenth of the world's population.[1]

Definition.

The Encyclopedia Britannica defines insurance as follows: "The provision made by a group of persons, each

[1] World Almanac -- p. 284

singly in danger of some loss (the incidence of which cannot be foreseen), that when such loss shall occur to any of them, it shall be distributed over the whole group."

Life insurance is a scientific method for bringing together the small contributions of many, for the mutual protection of each contributor or policyholder. These contributions are called premiums.

A man may have contributed for only a year or two, when, as a result of his death, his premiums will cease and his insurance will be paid to his dependents. The remaining policyholders, however, will continue to contribute enough in order that the insurance company will be reimbursed for this apparent loss and will accumulate enough to pay all other claims as they arise.

The fund collected from policyholders is greatly augmented by the magic of compound interest otherwise the premiums would necessarily be much larger than they are.

Although nothing is more uncertain than the life of the individual, there are few things more certain than the average life of a large group of people or the total combined lives of a large group of people; especially

when allowance is made for the continued improvement in the mortality rate. The many years of experience of the insurance companies and the American Experiences Table of Mortality, therefore, enable the insurance companies to determine how much must be collected from people of various ages in order to accumulate a fund which, invested at compound interest, will be large enough to pay all claims when they come due and, in addition, to pay a proportionate share of the running expenses of the insurance company.

Purpose of Life Insurance.

What are the needs which life insurance seeks to meet?

The first need of a man with dependents is for a death benefit to become immediately available should anything happen to him. The man may thus be enabled to go about his life's work, secure in the knowledge that his dependents will be provided for and his obligations met.

Alongside of this need is the requirement of the individual who outlives his productive period of life and has not a fund to draw upon to sustain him in his later years, when his earnings must perforce fall short

of his needs. In addition, life insurance is useful in meeting such special needs as the obligation to pay off a mortgage on the home, or providing a fund for a son or daughter for college and a start in business.

For the wealthy policyholder, life insurance provides a liquid fund for the payment of inheritance taxes, administrators' fees and other costs and items that reduce the decedent's estate appreciably.

It also makes available the continuance of contributions towards the support of an individual's favorite religious, educational or philanthropic charities.

Partnerships and corporations have come to look upon the instrument of life insurance as a means of providing partial compensation for the loss of important members of the firm upon whose continued existence the future success of the business may in a large measure depend. The lives of such officers and employees are nowadays frequently insured for the benefit of the firm as beneficiary under what are known as corporation policies, the firm paying the premium and exercising all the rights made available by the policy contract.

Types of Life Insurance Policies.

There are four principal forms of insurance policies

as follows:

1. Term insurance
2. Ordinary life
3. Limited-payment life
4. Endowment

Each form is intended to serve a definite purpose: therefore, before buying any insurance, the purpose of such insurance should be carefully considered and the policy selected accordingly. As the purpose of most people is to obtain a large amount of insurance at the lowest possible cost, I will deal largely with that sort of life insurance, which seems best suited to fulfill this desire.

Let us assume, for example, that I am a young man thirty years of age, wanting insurance protection for my wife and child, in case I should be taken from them before I have had time to accumulate an investment estate. Assume further that I have a good position, that my salary will be increased from year to year, and that later I will be able to spend more for insurance. At present, however, I can afford to spend only $180 for insurance.

According to the published rates of one of the old line companies, I find that $180 will pay the first annual premium on the following amounts of insurance at age

thirty:[1]

Five-year convertible term	$16,100.
Ordinary Life	7,700.
Twenty-payment life	5,400.
Twenty-year endowment	3,600.

With other companies these amounts may be more or less, depending upon their premium rates.

Upon thinking of my insurance needs, it seems a conservative estimate, assuming conditions as above outlined, that should I die at age thirty, the expenses of my widow will be about $2,000 a year and, in order to provide this amount until she can adjust herself to the new conditions and be able to take up some gainful occupation, I must have at least $10,000 worth of insurance.

Obviously in this case, with only $180 to spend for insurance, I cannot consider either the twenty-payment life or the twenty-year endowment policy; in fact, even the ordinary life policy will not give me the protection I need. I must, therefore, consider taking $5000 on the ordinary life plan at a cost of about $116; at age thirty, and a $5000 five-year convertible term policy, at a cost of about $56, or a total of $172 for the first year.

[1] The Connecticut Mutual Manual

After five years of salary increases, and as a result of dividends, I should be able to convert my term policy to the ordinary life plan. Perhaps I may make it more apparent why the above combination appears such an ideal one to me by making a few comparisons.

Let us now consider the twenty-payment life plan as compared with the ordinary life plan for a man who has a limited amount to spend for life insurance, and who needs considerable insurance protection.

The principle for the limited-payment life policies is that one's insurance can be paid during the twenty or thirty years when one's earning power is greatest, and then there will be no further payments to worry about in later years when one's earning power might have been reduced.

This might be an argument for those who can afford to pay the larger premiums on the twenty-payment life policy and still carry as much insurance as they should have. It is the opinion of several insurance men, with whom I have talked, said opinions being based upon observations, that most salaried workers who carry a twenty-payment life policy are under-insured.

Take, for example, my own hypothetical case, outlined above, which is typical of many salaried workers

starting on a business career. If, when thirty years old, with a wife and child, I should spend $180 a year on a twenty-payment life policy, I could buy only about $5400 worth of insurance, or only enough to support my wife and child for about three years, provided that $2000 of the principal is withdrawn each year in monthly payments, and the remainder is left with the insurance company and allowed to draw interest at about 4½%. Insurance companies usually guarantee only 3 or 3½% interest, however, they pay more if and when they earn more.

To certain classes of workmen whose earning power is likely to decrease or cease after twenty or thirty years, the limited-payment life policy is very attractive, because it overcomes the objection to paying premiums throughout the entire life of the insured.

Whether or not the insured will pay more or less in net premiums under the twenty-payment life policy, as compared with the ordinary life policy, depends entirely upon how long the man may live.

Since the twenty-payment life policy does not seem to have any advantage, in so far as total net premiums are concerned, until a man reaches old age, and since

it has the disadvantage of not providing as much insurance for the same premium as either the ordinary life policy or the five-year convertible term policy, it would seem that the worker, who needs maximum protection at minimum cost, should not allow himself to be influenced too much by the limited number of payments, or the greater cash value of the twenty-payment life policy.

In the above calculations I have disregarded cash and loan values because here is considered only the man who buys insurance for the protection of his dependents. How much cash he could get in case his dependents no longer need insurance protection or pre-decease him would be purely incidental. The same is true of loan values, because no one should borrow money on an insurance policy except as a last resort.

Let us assume that my family is sufficiently well protected by my present life insurance in case I live long enough to pay the mortgage on my home. However, if I am taken from them before my mortgage is paid, and if some of my life insurance would have to be used to pay this mortgage, then perhaps, my insurance will not be sufficient to carry out my plans.

Under such circumstances I should resort to a term

policy for the period during which I expect to be able to pay my mortgage. Such a policy will not only protect my mortgage at minimum cost, but it will also protect my other insurance.

A mortgage is an obligation which some day must be paid. Where no insurance is provided for such purpose, it frequently results in a foreclosure and a sacrifice, due to a forced sale.

If a person cannot afford to buy enough term insurance to pay off the mortgage in case of his death, he should buy as much as possible in order to reduce his wife's carrying charges on the home and increase her equity in this investment.

The principal advantage claimed for an endowment policy is that it enables one to create a reserve fund for one's own benefit.[1]

Before deciding to use insurance for this purpose one should seriously consider how much such a policy will affect the insurance protection which he should give to his family. If he finds, for example, that, for a given premium at his age, he can buy $10,000 worth of insurance under the ordinary life plan for the protection of his family, and only $5000 under the twenty-year endowment plan, and if the latter amount will not give

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[1] Life Insurance -- MacLean -- p.45

adequate protection to his family, then he should consider whether it is more important to adequately protect his family or to accumulate a reserve for himself.

If a young man buys an endowment policy as an investment for his own old age, and if he marries later and wants to convert his endowment policy to the ordinary life or limited payment, in order to obtain greater protection for his family, he cannot do so without another medical examination. If, for any reason, he cannot pass such examination, then he may find himself without sufficient insurance protection. Whereas, if he had taken the ordinary life policy and later decided to convert it to an endowment for himself, he could do so without an examination.

There are many other types of policies we could go into, but let us just mention a few of the most important.

With regard to the number of premium payments required under various policy contracts, reference should be made to the life and endowment policies which are sold on a "single premium" payment plan. Because of the size of this premium, this form of contract necessarily appeals only to people of means who are, however, enabled to promptly utilize the policy as collateral security due to its large and immediate cash and loan values.[1]

[1] Life Insurance -- MacLean -- p.43

Joint Life policies are offered by many life insurance companies, but their sale is usually discouraged in favor of separate insurance contracts. A joint life policy might be desired by a husband and wife so that the principal sum would be payable to the survivor upon the death of either person. Or a partnership might desire a single policy on the lives of all the partners, the face amount to be payable to the surviving partners upon the first death among the partners.[1.]

Some of these special policies are merely combinations of the four chief plans already described. Thus, there is the policy form which calls for a low premium for a number of years and a higher scale of premiums for the balance of the term. The so-called "Modified Life Policy"[2.] is a popular example of this arrangement, the rate of premium doubling after the first period of three or five years. Many companies offer an interim term endorsement at a small term premium to insure the applicant during the period of a few months preceding the effective date of the regular life or endowment policy to which this provision is attached. In this way the insured may be protected under term insurance pending the time when his improved finances will permit the payment of the higher premiums called for by the more perma-

1. Life Insurance -- MacLean -- p.58
2. Life Insurance -- MacLean -- p.42

nent forms of coverage.

Other special policies provide for a decreasing scale of premiums to appeal to those who are now in a position to make large premium deposits, so as to reduce the future premium outlay.

Instead of varying the premium payments, some forms effect a decrease in the amount of insurance after a stated period of years, thereby also reducing the total premium outlay. The "mortgage redemption policy" generally provides for a decrease in the amount of insurance protection corresponding to a decrease in the amount of an outstanding mortgage on the insured's home. In the event of the premature death of the home buyer, this policy makes available a mortgage-free home.

Value of Insurance.

Life insurance has but one purpose, as I see it, namely, the provision of an estate for the insured, live or die. Life insurance says to the policyholder: We will give you an estate, in the event that you do not live long enough, but we will also give you an estate in accordance with your original desire if you do live. Live or die, the purpose of life insurance is to create an estate, and by doing that, it meets the greatest eco-

nomic desire that any human being has, namely, the accumulation of a decent competence.

The fortunate thing about life insurance is the combination of the savings fund with the protection fund. That savings fund is constantly growing for the simple reason that protection must be kept up. Every man will have a terrific hankering once in a while to get that money. The stock market may be low; he would like a new car; oh, there are thousands of things that touch the spending proclivities of man. But he can only get that money by erasing the name of his wife and children and that he can't do. A thinking man can't get himself to do that act, and so he doesn't get the money. There it is, growing. He is simply a premium payer, and he keeps on paying his premiums. He is broke practically all of the time, but he is getting richer all of the time, and as he is getting richer he is getting happier and happier.

Life insurance is a will absolutely, under the terms of which a man can bequeath to his heirs--we call them beneficiaries--the money worth of the forces within him, just as in the case of a property will he leaves to them his property possessions. The analogy is complete. The policy is the will, the insured is the testator and the

beneficiary is the devisee.

The life insurance investment is an absolutely sound investment, using the word investment in its strict sense, namely, putting to use a sum of money for a reasonable return with absolute safety as to principal and income. The life insurance investment is practically secure as to principal. The loss that has resulted in the past twenty-five years, despite the biggest panics and depressions, is infinitesimal in this country.[1] I think there is no financial institution that can show the record of solvency that life insurance can.

The return on the investment is reasonable--that is, the return on the investment portion as distinguished from the amount that you pay for the decreasing term.

You have bought dollars with dollars. The investment is also psychologically the correct one.

The life insurance method of investment and saving represents the slow, sure, compound interest method, as distinguished from the speculative method. It is the old question of the race between the tortoise and the hare. We are all racing for a competence, only we adopt different methods.

Those who try to make it quickly by leaps and bounds are apt to take a nap, and when they once go to sleep

[1] World Almanac -- p.284

under the speculative method, especially when age forty-five or thereafter has been reached, the sleep is usually a permanent one financially.

The tortoise method is the life insurance method, the slow, sure, compound-interest method, where the running actually becomes more pleasant the longer you run because you have the consciousness of the certainty of accomplishing the purpose you had in mind.

Judged by all the requisites of a good investment, the life insurance investment is one hundred per cent. And, unlike any other investment you can name that is bought on the installment plan, the life insurance investment is the only one which promises that in the event that you cannot continue to pay the investment, the entire investment will be fully realized and all the unpaid installments will be promptly paid for you.

It might be well to mention at this point that failure to pay premiums and forfeiture are often the causes of loss.

History of Annuities. [1]

Annuities as a form of investment have been in use for hundreds of years. Because of the loss of records and the crudeness of business transactions in ancient

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[1] What Everybody Wants to Know About Annuities -- Fitch
Ch. 12

times, there is not much known about annuities among the ancients. Undoubtedly the highly-developed ancient civilizations had this form of business investment. And, of course, regular payments to various individuals by the kings and the governments of all ancient civilizations were annuities.

Annuities are specifically mentioned in Roman records about two thousand years ago. In the year 40 B.C. a law was enacted by the Roman Senate bearing on annuities.

Naturally during the Middle Ages, when civilization was at a low-ebb and wealth was so repeatedly destroyed, there were no annuities in the modern sense.

With the advance of civilization, and the development of commercial activities, and the rise of the "business man," as well as the stabilization of governments, annuities came into vogue. This was about the end of the sixteenth century.

Beginning with the year 1600 we find records of persons in Holland paying to the Government certain sums, upon receipt of which the government undertook to pay annually another stipulated sum to the annuitant for life.

So extensive became this form of investing that within a hundred years a book was published giving the theoretical value of annuities. While in this book,

written by Edmund Halley (1693), the discoverer of Halley's Comet, the basis for the calculations was purely arbitrary, some of the principles laid down for annuity payments are valid today.

In Europe, governments sell annuities, and perhaps most of the annuities there are bought from governments. In fact, so popular are annuities, and so common is the annuitant that, in England for instance, when speaking of a man's wealth, he is not said to be a "millionaire," or to be "worth 500,000 pounds," but he is "worth 50,000 pounds a year," or 5,000 or 1,000 pounds a year," and so on.

Definition.

An annuity is a device by which an individual may receive a stipulated income annually for a definite period of time, or for life. Payments to the annuitant--the one who receives the income--may be made monthly, quarterly, or semi-annually, but they are called annuities just the same. Needless to say that an annuity is permanent and sure in direct proportion to the safety, permanence and stability of the individual, organization, institution or government which agrees to pay it.

Generally speaking, annuities are entrusted to and are paid by trust companies, insurance companies, and,

particularly in Europe, by governments. In America, most annuity contracts are sold by life insurance companies.[1]

An annuity may be said to be a regular "salary" for life.

Because annuities are handled by life insurance companies, and because life insurance companies often handle death benefits as annuities, many people confuse the two kinds of payments.

As a matter of fact, one kind is really "life insurance"--that is, an annuity that is paid to you while you live. The other kind is really "death insurance," which is paid to your family or your estate when you die. The latter form of insurance has been called life insurance, and is known as life insurance, because it is insurance on the lives of various individuals. But, from the standpoint of the man who pays the premium, an annuity is "life insurance" because payments are made to him while he lives.

However, in the handling of these funds, and in the actuarial work in determining values, life insurance is based on an entirely different principle from that of an annuity. In the one case, the life insurance company pays the insured on a rate based on mortality

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[1] What Everybody Wants to Know About Annuities -- Fitch -- p.17

tables. The life of any one individual is the most uncertain thing in the world. But the lives of a hundred thousand individuals are about as certain as anything can be--so many will die at the age of forty, so many at the age of fifty, and so on. The law of averages is positive and exact. On the other hand, the person who receives an annuity is more apt to out-live the average, as shown by the records of the leading companies. Consequently, the institution or business that attempts to pay an annuity must base its calculations upon extra long lives.

On life insurance, as applied to any particular case, an insurance company gains if the insured lives longer than the average for his age. On an annuity, the insurance company loses. It is important to understand this difference in considering the investment of funds in annuities.

Types of Annuity Contracts. [1.]

The Immediate Annuity is for those who apparently have the necessary capital to invest in a lump sum and who are in a position to have their capital used up. The rate of return, of course, depends upon the age of the annuitant at the time of purchase. Naturally, the older the annuitant, the greater the rate, since more of his capital can be returned to him in the annual payments.

[1.] What Everybody Wants to Know About Annuities -- Fitch -- p.23-27

The return under an annuity contract is made up in part of interest and in part of a return of the principal paid to the company. Thus the principal is generally exhausted. After providing a margin of safety the proper return can be fairly well calculated in advance by assuming the interest that the money will earn in the hands of the company and the number of years that the annuitant can be expected to live.

Experience tables have been compiled to show that, as a matter of fact, annuitants live longer than the average. There is certainly a foundation for this in view of the fact that an annuity absolutely banishes all financial uncertainty if the insurance company is sound. An annuitant has no worries of that kind. He does not have to struggle for a living. He can spend his time living and enjoying life. He can protect his health when others may have to force themselves to work at a sacrifice of strength and energy. There are a multitude of reasons why the annuitant should live longer than the average.

A comparatively small amount of capital will purchase a modest income and no person of advanced years should be overlooked simply because he does not have a large amount to invest. As a matter of fact, an old person

trying to live on the income from a few thousand dollars would be far better off by purchasing an immediate annuity and getting the return from interest as well as a scientific distribution of principal. The element of safety comes from the fact that, no matter how much of the principal the company actually distributes over a period of years, it is always liable for the sum stipulated in the contract. The annuitant can never outlive his guaranteed income.

The man with dependents may adopt an annuity plan which, under limited circumstances will give something to his beneficiaries. This is the refund annuity. It is simply an immediate annuity with the further provision that, if the annuitant dies without receiving the amount which he paid for the annuity, his estate or beneficiaries named by him will receive the balance. Naturally, the annuity payments under the refund annuity are somewhat lower than they are under the straight life annuity on account of the liability of the company to repay at least what the annuitant paid, whether or not he lives.

The joint and survivorship annuity is applicable primarily where there are two persons, such as husband and wife, without any further beneficiaries to be concerned about. An immediate life annuity to cease upon the death

of the husband certainly would not take care of the situation where there is no other provision for the wife. Neither would a refund annuity do, since the husband might live long enough to receive all that he had put into the contract.

One solution in this case is the joint and survivorship annuity which continues the payments to the survivor of the two as long as he or she lives. Naturally, the income that can be purchased under this contract with a given sum is less than that given under an immediate annuity, payable during the life of only one person. The company is liable for payments over the lives of two persons. Nevertheless, the contract is ideal for many couples of advanced age. They can make their principal go farther in this way than in any other, and still have the certainty given only by a contract backed by the resources of a life insurance company.

Immediate annuity combined with single premium life contract is rapidly coming into favor with those who want immediate income and yet who want to hold the principal intact to be transferred at death without tax or shrinkage of any kind. The income from the annuity plus the dividends on the life contract, if it is participating, provide the income during the life of the purchaser. The

insurance contract guarantees that the estate will be intact one hundred per cent at death. The combination of the two contracts forms a more or less ideal arrangement for dissipating capital and at the same time creating it, thus guaranteeing an income to the purchaser and to his dependents as well.

To illustrate the arrangement in one company, one which can be duplicated in other companies as well, take the case of a man, age forty. For a total of $1,000, if he can pass the medical examination and for slightly more if he cannot, he can purchase two contracts. One is a single premium life contract which will pay $1,000 at his death to his beneficiaries. This contract is participating and pays an annual dividend of $11.85 on the average. The other contract is an immediate annuity and pays an income of $34.27 per year. This is an average income of $46.12 per year or better than 4½% on the purchase price.[1]

This plan solves both problems for the man with dependents who has the money to invest. He has the immediate income without sacrificing anything in his estate. Furthermore, this type of contract is particularly attractive for an individual of wealth on account of its tax advantages. The return from the annuity portion

1. Connecticut Mutual Life Insurance Company

($34.27) each year is exempt from income tax until the aggregate amount received exceeds the amount paid for the life insurance contract.[1]

As far as state inheritance taxes are concerned, the proceeds of the insurance paid to named beneficiaries are free from tax in their entirety. There is a $40,000 exemption from the federal estate tax if the insured reserves the incidents of ownership of the policy. If the insured gives these up to the beneficiaries the entire amount of the life insurance will be free from federal estate tax at his death.[2] Consider the great saving in taxes that can be made in the case of a substantial estate. The income tax saving is often sufficient to raise the net rate of return by several per cent and the inheritance tax saving is sufficient to save a large portion of the capital at death.

Additional advantages of this plan are, of course, freedom from probate and administration expenses; also freedom from creditors' claims if the insurance is properly payable.

A type of contract which will conserve the capital both for the estate and the purchaser during his lifetime and at the same time give an income to the purchaser is the single premium short term endowment, generally two or

[1] Federal Income Tax - 1934 -- Item B. "Exemptions".
[2] Federal Revenue Act of 1934

five years. At maturity or before, if the contract is surrendered, the fund is allowed to remain with the company under the option of settlement chosen by the owner and after his death the fund is paid over or the payments are continued to the beneficiaries named in the contract.

In analyzing the two-year and five-year endowments it is not entirely clear what the status of the payments is after the maturity or surrender of the endowment, leaving the proceeds with the company under one of the options of settlement. The income tax law exempts payments made under a life insurance, endowment or annuity contract until the amount received exceeds the amount paid. The estate tax law exempts the proceeds of life insurance contracts payable at death under certain conditions. The question resolves itself into whether a matured or surrendered endowment held by the company under one of the options of settlement can still be classed as a life insurance, endowment or annuity contract so that the payments can get the benefit of the exemptions given by law. If so, the tax exemptions are comparable to those given under the annuity-life insurance plan. If not, the situation is the same as money held on deposit by the insurance company. An income tax would be imposed on the

income each year and an estate tax on the full amount of the principal.[1]

It is impossible to give an absolute answer to this question. There would seem to be sufficient doubt, however, to indicate that the annuity-insurance plan is the safest to recommend to a person of wealth in order to guarantee the greatest saving in taxes. Where the tax saving is not important and the return and other advantages would be greater under the endowment plan, that naturally is the thing to purchase.

Present economic conditions have caused much attention to be put upon annuities to fit the popular demand and the popular purse. So we have the deferred or retirement annuity, which is a contract providing for an annuity to begin at a specified age in the future. Not only does the contract differ in this way from the immediate annuity but it also differs in the manner of paying the premiums. In the case of an immediate annuity the whole premium is paid at once. In the case of the deferred annuity the premium may be paid in annual installments until it is time for the annuity payments to begin.

Remember, always, that the result is guaranteed by contract and backed by assets that are sufficient to make the guaranty secure. Tax advantages, of

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[1] Wills, Trusts and Estates -- J.L. Madden -- p.228

course, make the investment doubly attractive to the person to whom taxation is a problem and it is always a thing of interest even to the small investor. There is no income tax on the accumulations during the premium paying period, and of course, no tax on the annuity payments until they exceed the amount paid to the company.[1]

The field for the deferred annuities has barely begun. There is a large future in this type of business, not only among men but among business women who are more and more becoming self-supporting and who have no dependents. The deferred annuity is proving an ideal arrangement for them and is particularly attractive after the recent investment experience of many.

The plan of discounting premiums has received more attention in the last few years than ever before. The fact that many companies will accept annual premiums in advance at a liberal discount gives the purchaser a safe place for his money with a good return.

Under this plan the total value of the investment at any one time is the premium fund, the cash value of the contract and the dividend accumulation, if the contract is participating.

[1] Wills, Trusts, and Estates -- J.L. Madden -- p.228

The following summary may prove helpful in choosing the proper form of annuity:

Immediate Annuity. Broadly speaking, this form is advisable if there are no dependents to consider or if they are taken care of in other ways.

Joint and Survivorship Annuity. Where only husband and wife are to be considered.

Refund Annuity. Where it is not necessary to provide for dependents but desirable to do so and the annuitant is willing to take a lesser income on the possibility of leaving something.

Retirement Annuity. Where the prospect is young enough to make the necessary accumulation over a period of years and where his program also includes sufficient protection to his dependents, if any, in the event of his death.

Ordinary Life. Where situation of dependents is of primary importance but prospect has sufficient resources to build up his cash reserve in this way; annual or single premium; dividend accumulation or addition, if participating and money is not essential for immediate use.

Limited Payment and Endowment. Where capital for dependents is important but prospect has resources with

which to build up cash reserve quickly; dividend accumulation or addition if possible.

Short Term Endowment. Where situation requires an investment to conserve capital and at the same time give the maximum interest return.

Combined Program of Immediate Annuity and Single Premium Contract. Where individual is wealthy enough to make the tax saving a real factor and desires the conservation of his capital for his estate with the best interest return.

Advantages.

The greatest fear of the thoughtful man is the fear of old age. It is often even a greater fear than the fear of death. The reason is that old age, poverty and dependence are most distressing, and are terrifying to contemplate. If everyone could be assured of a peaceful old age, with enough money to pay for small requirements--for food and lodging, and the little comforts of life--there would be much less unrest, and much more happiness in the world. An assurance of enough income to be independent after one has reached the age of retirement makes for peace of mind. The thought of it gives peace of mind to a middle-aged man or woman. The income, itself, gives peace of mind to older people

when they have quit work.

It is also a remarkable fact that a regular income adds years to the lives of those who receive it. Hard work does not often hurt people, but worry does. The man with a regular income in his later years is in a happy frame of mind, and the records show that he actually lives longer. Insurance records show that, when financial worries are removed, years are added to the average life.

Annuitants pay no Federal income taxes on their annuity income. This holds true until the income reaches the total amount paid in. In other words, when an annuitant has received as much as he paid for his annuity, then he must pay an income tax on his remaining annuity payments. Naturally for small sums this would be nil, or very little. An annuitant likewise pays on his annuity no taxes to cities, states or other political sub-divisions.

Annuities cannot be attached by civil process, and, in most states, they are exempt in the event of bankruptcy. This is an important feature of an annuity as an investment. Every safeguard has been thrown around the annuity by law to preserve it.

You do not have to be examined by a doctor to

get an annuity. There is no "red tape" and no trouble. Annuities can be purchased as easily as buying food or clothing, or putting money in the bank. Anyone can buy an annuity.

There is considerable trouble in the handling of funds. For instance, if one owns bonds the coupons must be clipped on the day they are due, and presented for payment. Bonds mature and they must be re-invested. Mortgage-loan interest payment dates must be watched. Rents must be collected. The larger the amount which one has to invest or handle the greater the amount of details involved and there is consequently more trouble. Annuities do away with this trouble and bother.

After a person is fifty years old money invested in an annuity begins to return more than 5%. It is true that it does this because of the gradual wiping out of the capital. But in the later years the return is so large that it is an appealing investment.

At sixty-five, money invested in an annuity yields about 10% and the return increases with the increasing age at which the annuity begins. In other words, the older a man or woman when annuities are purchased, the larger the return for the capital. For instance, a man seventy-five years old, with $10,000 can buy an in-

come of approximately $1400 a year ($116 per month) as long as he lives. [1]

As Investments.

There are only two minor objections sometimes urged against annuities from the investor's standpoint. One is that the capital invested in annuities is lost in the sense that it cannot be handed on to the next generation. (The only variation from this would be the right of the estate to receive by special agreement the difference between the amount paid for the annuity and the amount received by the annuitant, in the event of early death).

Insofar as this objection is concerned, a man who buys an annuity, even if he leaves no estate as a result of his purchase, is really benefitting his family. He will not be dependent on his family--as something like 70% of individuals who live to be sixty-five years old are dependent on their families and have to be supported by relatives. A man who has an annuity saves them this trouble and expense for years.

If he buys an annuity, he is therefore not selfish, as it would seem, because he is not depriving his family of anything, but he is helping them out by not becoming an object of dependence.

[1] Annuity Rates -- Connecticut Mutual Life Ins. Company

The other objection is that the investor--particularly if he were young--could perhaps earn a larger income from the same capital. As will be shown later, in order to do this, however, he will often speculate, when he thinks he is investing, and his larger income is not always sure.

Now experienced investors and students of business and economics know that whenever an investor attempts to earn over 5% on his investment, he is on the borderline of speculation, rather than investing. In other words, it has been found from experience that the upper limit of safety is usually between 4½% and 5%. Any income or interest exceeding this is paid because of speculative features, or the uncertainty of the investment, or a greater risk.

An annuity, then, when issued by a properly managed insurance company, is safe because of the observance of this fundamental rule of investing.

The first requisite of an investment is safety, and it is very hard to have safety and earn over 4½%. Insurance companies that invest hundreds of millions of dollars of the public's money have found that this rule holds true. The experience of several of the larger American companies, now extending over nearly a hundred

years has proved it. Consequently, most companies do not promise to pay over 3½%, so as to be on the safe side. They ordinarily pay a larger interest rate than this, but they often pay it in the shape of dividends or in a bonus rather than in guaranteed amounts. However, annuities are paid in certain stipulated payments, and do not fluctuate with the interest rate.

Chapter 3

SAVINGS BANKS

History in the United States.[1]

In the colonial days in America there was great scarcity of money and the first banks were established to supply this need. The earliest bank was founded in Massachusetts in 1714.

After the Constitution was adopted banks were organized in the different states, and the first Secretary of the Treasury, Alexander Hamilton, promptly set about having a United States Bank.

The ruin of the United States Bank was wrought by politics in an exciting period and was started in a miserable local intrigue to discredit the management of an insignificant branch at Portsmouth, New Hampshire, when it was at the height of its prosperity and usefulness.

State Banks were established even before the first United States Bank was chartered, and they increased in number and variety in the different States, until the time of the Civil War, gradually working through confusion toward a sound system.

[1] Banking & Business -- Willis and Edwards -- Ch. 25

One feature deserving particular attention was the sound system of redemption established in Massachusetts by the cooperation of Boston banks and without the sanction of law. Boston became in effect a reserve city for New England and the Suffolk bank a clearing-house for notes.

The Government began to meet the war expenses (1861) by means of loans instead of increasing revenues. Early in 1862 legal-tender notes were issued without interest and with no provision for redemption, and the result was a general disappearance of coin and depreciation of the whole paper currency.

Already there had been proposals for national banks but Congress was reluctant to resort to this expedient. It came to it, however, early in 1863 through a mixture of motives.

(1) To secure a market for bonds in this country.

(2) To supply a safe and uniform currency.

(3) To diminish the necessity of issuing a large volume of irredeemable Government notes.

(4) To facilitate an early return to specie payments.

The first Bank Act of February, 1863, was defective and it was superseded by the Act of June, 1864, which remedied some of the defects and made liberal provision for the conversion of the State banks to the national system.

A bureau was established in the Treasury Department, under the charge of a Comptroller of the Currency, to attend to the execution of all laws relating to bank currency.

The system has proved an exceptionally safe and stable one for the general purposes of banking, though there is a point of weakness in the multitude of small banks scattered over the country in place of strong institutions in commercial centers and cities of importance, with branches in smaller places. The latter would be able to employ their resources more widely and furnish capital more readily wherever it was needed, and the result would be greater uniformity in the rates for loans as well as greater security for all concerned.

There is a strong tendency to consolidation, combination, and extended control in banking, as in other businesses requiring the use of large capital, and it is likely to go on with only a part of the advantages of "branch-banking" and some disadvantages which that

does not involve. However, with the requirement of fully paid-up capital, a constant surplus, Government supervision, full reports of condition, and frequent examinations, there is little danger of abuses of power and none of monopoly.

Definition.[1]

Savings banks are voluntary trusteeships, undertaken by a few persons in a particular locality, either self-appointed, renewing their own number as vacancies occur, or chosen by the depositors. The corporate body thus formed receives deposits or funds small in amount, and from the poorer classes of society. It undertakes to invest them with due diligence in the safest practicable way, and to divide all the income, after paying necessary expenses, among the depositors, at stated and convenient times. None of the profit on these investments belongs to the corporation itself. All of it belongs to the depositors. If a surplus is created, it is only for a safeguard against occasional losses or emergencies. In every respect, the corporation is nothing but the agent or trustee of the whole body of depositors, and works for their account and benefit, not for its own.

The chief business of a savings bank is to aid the working people in saving a portion of their income. Savings banks are not institutions for the wealthy to

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1. Practical Banking -- A.S. Bolles -- p.151

patronize--they should invest their own funds. The savings bank through combining the various small deposits made is enabled to gather up a very considerable sum which it may invest in the securities of companies which the state laws deem safe. In this connection it may be seen that the depositor not only secures the benefits of the skill and judgment of bank officials in the investment of his funds, but receives state guidance and supervision as well.

Types of Savings Banks.[1]

The mutual type was the original bank for savings and they were established in New England and New York during the early half of the nineteenth century.

The purpose in organizing a mutual savings bank has been philanthropic rather than commercial, Originally these institutions were established to encourage thrift among the poorer class. The organizers were actuated by charitable motives and were not expected to derive any profit. This theory is still applied in the case of the mutual savings bank, for it is organized and operated by a group of persons known as trustees, who are forbidden by law to receive any compensation for their services. In fact, the organizers must contribute to an initial fund

[1] Banking and Business -- Willis and Edwards --Ch.20

to meet the expenses of starting the bank and to operate it until earnings render it self-supporting, at which time the contributions are returned.

The mutual savings bank is not operated through capital derived through the sale of stocks, for the business is conducted through funds left by depositors, who are the real owners of the bank. Thus the income which they receive is technically called a dividend, but because of its certainty of payment and stability of rate it is popularly regarded as interest.

Although the depositors are in a sense the owners they exercise neither control over the management nor choice in the selection of the trustees. The first trustees are appointed by the organizers and later additional trustees are elected by the board itself, thus constituting a self-perpetuating body.

The mutual savings bank system has not extended to the West and South. Banks in this region are established not for philanthropic reasons but for profit and are therefore organized the same as any other corporation. They are called stock savings banks, and their earnings are paid to shareholders, while the depositors receive a specified rate of interest. The stockholders also have the right to elect directors, who control the affairs

of the bank.

Many institutions, especially in the West, combine both savings and commercial banking. As a rule these banks engage primarily in commercial business and only incidentally operate a savings department. At first trust companies and later state banks were allowed to receive savings in addition to carrying commercial accounts. Since the Federal Reserve Act many national banks now operate such departments.

Guaranty-fund banks are another type of savings institution which prevail in New Hampshire. This bank handles no commercial accounts and its funds are derived from savings deposits. The distinctive feature of the guaranty bank arises from the division of its deposits into general and special. The general deposits bear a fixed rate of interest. After this interest has been paid the remaining sum is paid on the special deposits. In a way general deposits of the guaranty bank resemble preferred stock and special deposits may be compared to common stock. In return for higher earnings, the special depositors assume a proportionately greater risk.

Similar to the mutual savings bank is the building and loan association or cooperative bank. These associations are owned by the shareholders. The loan associ-

ation generally grants accomodations only to its members. Savings banks distribute their funds over a wide range of investments but loan associations confine their activities to assist persons who are buying real estate or building houses.

The postal savings banks were inaugurated in 1910 as a device to give greater security to small depositors and to attract deposits from hoarding, particularly by the foreign and other elements of our population which tend to be suspicious of banks. The system is controlled by a board of trustees consisting of the Postmaster-General, the Secretary of the Treasury, and the Attorney-General.

The amount which any person may deposit in his interest-bearing account is $2,500 and accumulated interest and in his non-interest-bearing account, $1,000. Deposits may be withdrawn on demand and paid by postmasters out of their daily postal receipts and out of a small working balance carried by them in neighboring banks. The system is highly decentralized, the local postmaster keeping the records of individual accounts, crediting deposits and debiting withdrawals.

The rate of interest is fixed by law at 2%. This rate removes the system from competition with existing

banks and makes it possible to loan out the funds at a profit, thereby making the system self-sustaining and a feeder of other banks.

Advantages and Disadvantages of the Various Types.

The mutual savings banks offer the greatest advantages to depositors. They are not run for profit, hence the depositor stands a good chance of getting a higher rate of interest than the other types of savings institutions offer.

The only disadvantage, if one may call it that, is the fact that the owners or depositors have no say in the choice of trustees who manage the bank.

The stock savings banks are operated for profit and pay a fixed rate of interest to the depositors. The shareholders elect directors to manage the bank and it seems to me this is a disadvantage. We hear quite a bit about people who own a controlling interest in some corporation and proceed to put their own pet ideas to work when their favorite is elected. This, I should think, could easily happen to a stock savings bank with disastrous effects.

Savings departments of commercial banks are offering competition to the mutual savings banks for new accounts. As a result, interest rates have often been

forced to a high level. Usually commercial banks have been able to outbid the mutual savings banks due to the fact that the latter's investments are restricted by law and their earnings consequently limited. This very fact, however, points out that the mutual bank has an element of safety that the other lacks.

The guaranty-fund bank has an element of speculation to it. It is just one step safer than the stock market. The general depositors are safe but the special depositors are running a risk which should not be the case in a savings bank. The savings bank is to be used by an individual to accumulate a fund for emergencies and it shouldn't be necessary to question its safety.

Cooperative Associations are ideal to save for a college fund for son or daughter or for an additional retirement fund or a trip, but a person shouldn't start one until the rainy-day fund has been taken care of in the regular savings bank. Money cannot be withdrawn from a cooperative bank before five years from the date of starting, without a loss of 20% of their profits, so it is no place to put money for an emergency fund.

The postal savings banks pay a very low rate of interest, namely, 2%. Furthermore, these banks do not allow interest for less than a year which is an unfair

practice producing a net profit of more than a million dollars a year. These banks are not very popular and very likely will not become more so.

Amount to Deposit.

How much should a young man, a single man, a to-be-married man, a married man, a man of any age, or a corresponding girl or woman, put aside as a saving or investment fund each week, each month, or each year, or during any other selected period?

To establish a set rule for anybody, save oneself, would be impossible.

It is obvious that the multi-millionaire, with an annual income of millions of dollars, can save ninety-nine per cent of his profits, and yet keep the wolf of poverty from getting any nearer to him than an adjoining street. It is self-evident that the family man whose wages are but a few hundred dollars a year, cannot put aside more than a small percentage of his earnings, or not more than a microscopic part of them, if he would give himself and his family the common and ordinary necessities of life.

The one rule of saving that can be established is, that it is the duty of everyone who can save, to save all he can, provided he does not sacrifice a greater duty

by so doing.

I rather like the expression "rainy-day" fund as it conveys to my mind a picture of just the part I believe the savings account should play. One should have neither too much nor too little in the savings bank, but just enough to provide for all the rainy days that may be expected. I believe it should be so planned that the person will not need to borrow on his life insurance, mortgage his home, or sell his securities in the event of any sickness or emergency arising.

Thus keep enough in the savings bank to provide for all normal emergencies at all times--investing in life insurance, real estate and securities only after the rainy day has been provided for, and I firmly and honestly believe you will never have cause to regret it. True, the return may seem small, but it is steady-- and slow and sure people are usually the winners in the end.

Method of Saving.

It is every man's duty to continue to save until he has reached the point of protection. It is better to save a penny a day for the sake of principle than not to save at all. There are few of us who cannot put away a

cent a day and if a cent is all that can be saved, save it systematically.

If you would command the respect of your employer, of your friends and of the world at large, save and save persistently, and be known as a provident man. Not only will you receive self-satisfaction and protection, but you will be better liked and be more respected by everybody.

The various clubs, such as tax clubs and Christmas clubs advocated by savings banks are excellent expedients to help form the habit of systematic saving.

If a man finds it necessary to withdraw money, for sickness or any other emergency, from his savings account he should regard it as a loan and return it as soon as possible. This rainy-day fund should not be touched except in case of real need. It is easy to withdraw money once started, but it is most discouraging when you see your bank account dwindling and find it necessary to practically start again.

If you have a legitimate reason for withdrawing, be sure you note the interest date. It would be a shame to miss your interest by one or two days.

For some people who are apt to let obligations to

themselves slide, a note from the bank might seem advisable. Having a note to meet at the bank is better than it sounds. You are likely to save more to pay off this note than you would otherwise save and, having met this obligation, you will have the satisfaction of knowing that your original savings are still intact. True, there will be a pause in your savings while the note is being paid, but you will avoid the discouragement of a set-back. In addition, you will learn how to make use of your credit and, when other unusual expenses arise, you may use these same methods to meet them. The loss due to interest will be slight because you are still getting interest on your savings account.

General Advantages of a Savings Account.

We have already urged the necessity of systematic saving. Even a weekly or monthly visit to the savings bank makes for good, for the depositor comes face to face with men of standing, and often with men of mark, and their acquaintance or friendship is worth cultivating. The depositor, who periodically calls at his bank, gradually attracts the attention of the bank officials, and this acquaintance, although it may not be intimate, is likely to be of some use to him.

A savings bank book of deposit is a positive asset.

It stands for more than its face value. It is a book of recommendation as well as of deposit.

A bank book is an excellent credit reference. If, for instance, you wish to open a charge account in any of our large department stores, they would ask to see your bank book for credit reference.

Your savings bank should be looked upon as a place where you can obtain good advice in regard to financial matters, such as buying investments, financing the purchase of a home, or borrowing money. Banks are no longer the cold, unapproachable institutions they used to be. Progressive banks are eager and ready at all times to advise their depositors on any financial problems.

Chapter 4

COOPERATIVE BANKS

History in the United States. [1]

America in 1831 was a growing and expanding nation, largely agricultural but with manufacturing and commerce rapidly becoming more and more important. The population was predominantly rural but in many parts of the country there were fairly large cities, some of them firmly established and with an existence of one hundred or more years behind them. In these urban centers there was emerging a wage-earning class to whom home ownership and a safe investment were almost a necessity. Thus through working together and living together the ground was prepared for further joint efforts of a definitely cooperative nature.

Certain specific comments are suggested by a study of figure No. 1, page 105. It should be noted that present evidence indicates that the movement spread from Philadelphia to New York. The question naturally comes to mind, why was the first jump so long, and doesn't it seem likely that a shorter jump may have taken the movement across the river into Camden or some other

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[1] History of Building and Loan in the U.S. -- Bodfish -- Part 1

nearby New Jersey town? To date, no facts substantiate such a supposition, but the prospects seem not unlikely that such an event was possible, and even probable.

The next earliest date which is recorded is the year 1843 when the movement is said to have begun in South Carolina. Here apparently was an instance of the seed having come from England rather than from Philadelphia. The description of the building and loan pioneers in South Carolina shows that this is true.

The next evidence of the movement is found in the states of Maryland, New Jersey, and Connecticut, all of which are credited with having their first building and loan associations established in 1849. These states are followed in order by Massachusetts, 1852; Maine, 1854; Virginia, 1859; District of Columbia, 1861; Georgia and California; 1865; Texas, 1866; and Ohio and Delaware, 1867.

The future of building and loan associations is good. Ownership is a fundamental desire on the part of 95% of the American people. It will continue and progress as price changes make it less onerous in some localities and extremely favorable in others. Taking the nation as a whole, such price changes are taking place at the present moment and augur well for home ownership.

Definition.

The cooperative bank or building and loan association is a combination of men banded together for mutual interests and protection. It deals exclusively in real estate and real estate mortgages, its loans as a rule being confined to its members. Its capital is obtained by selling shares, each shareholder having full voting rights, and something to do with the management of the business and the investments.

The shareholders elect the proper officers and committees, whose province is to invest or loan the money, presumably at the very maximum of safety. They are not supposed to take any risk. There is usually little or no opportunity for embezzlement or irregularity, because little ready cash is on hand at any time, the money being let out immediately with its coming in.

All money is loaned, either by vote of the shareholders in a meeting, or by a large committee chosen by the shareholders. The utmost caution is encouraged and every action is passed upon, leaving little opportunity for carelessness.

However, it is necessary to investigate the particular institution you are planning to put your money into as there have been failures.

Figure 2, page 106, will set forth clearly the work which is undertaken by these associations.

Probably no institutions perform a greater service for the development of community spirit than those which aid our people toward better housing. The old French maxim, "A man will fight for his home but not for his boarding house" is an eternal truth. The associations' contribution to the housing problem is evidenced by the following quotation from the "Wall Street Journal": "These associations promoting thrift and providing homes are really the only practical agency through which the housing situation can be solved, because they are nearer the working people and best understand their needs."

Types of Shares Issued. [1]

Installment stocks are the regular shares issued by Cooperative banks. In order to take advantage of this plan you simply go into the bank, fill out the signature card, and make your first monthly payment of any amount from one dollar to forty dollars. You immediately receive a bank book showing that you have paid so many dollars into the bank, let us say ten, and are therefore the holder of ten shares. You are now a shareholder and have agreed to make your monthly payment of ten dollars each and every month until your shares

[1] The Building & Loan Association -- Riegel & Doubman -- p.26-30

reach their matured value, or you find it necessary to close your account. Regularly, systematically, thereafter you must save this same amount of money, bringing it into the bank each month before the close of the "bank day."

If you find yourself in the happy position of having some money and being able to save regularly from your income, you may obtain shares for any amount you may have, from a few dollars up to several thousand dollars: for example, should you be able to save ten dollars each month you might obtain ten shares in a series having run five years and which is worth let us say, six hundred and eighty-two dollars and fifty cents at the time you wish to purchase, and which requires the saving of ten dollars each month until the shares mature, that is, reach the value of two hundred dollars each, a total of two thousand dollars. These are called prepaid stocks.

Paid-up shares may also frequently be obtained in like amounts, that is, from $200 up to $2000 in multiples of $200, certificates being issued showing your ownership and the dividend checks being mailed to you quarterly, or being set to work in payment of monthly

shares.

The investment of funds in paid-up shares differs from the preceding forms of shares as they require no further payments, as they are purchased for their full value plus the accrued dividend since the previous dividend date.

Guarantee stock, used principally in California, Oregon, and Colorado is used to guarantee to savings members a definite profit on their investment. No dividends and other liabilities have been paid. In good times there is opportunity for large earnings and vice versa.

Investment certificates principally in California where the population is not as familiar with the building and loan idea as in other sections. The certificates may only be issued where there is another fund which guarantees the contract rate of earnings on the certificates. They are comparable with the ordinary bank certificates of deposit.

Double-payment shares, used principally in New Jersey, for the purpose of maturing a given sum more quickly.

Juvenile savings are almost without exception in the form of installment shares, but they differ in that

no fees, fines, or penalties are enforced against them.

Regular Building and Loan Plan. [1]

To date the cooperative bank plan is largely that of the serial plan with either quarterly or semi-annual series, requiring monthly payments, subject to fines, with the option of leaving the shares as permanent investments upon their maturity should the bank care to accept them, in multiples of $200 but not exceeding $2,000 in any one name. Paid-up shares may also be issued up to 10% of the assets of the issuing bank in multiples of $200 but not exceeding $2,000 in any one name. Loans are made on first mortgages of real estate not exceeding $8,000 on any one piece of property, and are repaid on a monthly basis, the payment including shares with which to liquidate the loan and monthly interest. All cooperative banks must create a guaranty fund setting aside a portion of their earnings at each distribution of profits until the total amount equals 5% of the total resources of the bank.

Through the cooperative bank supply and demand meet in the fairest exchange possible--the savings and investments of some shareholders furnishing the money for other shareholders to acquire homes; the saver to receive the secured mortgage of his neighbor; the borrower

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[1] Building & Loan Associations -- Clark & Chase --p.38

to enjoy the blessing of a home through his neighbor's thrift.

The bringing of a home to the average family years before it could otherwise enjoy one is one great service rendered by this cooperation of money. The security of permanence is assured where the family has no fear of losing the home because heavy payments may be demanded or because the mortgage may suddenly become due.

The principle of amortization of debt paying is the most valuable system ever devised by human intelligence. To commence, immediately on the creation of the debt, to extinguish it by small monthly payments that at once begin to accumulate a sinking fund to liquidate the loan and also to pay the interest is the greatest accomplishment of cooperation.

In this bank plan the payments are adapted to the capacity and income of the borrower and the home is finally cleared of all debt. Under the old form of mortgage the tendency is to pay only the interest and continually to renew the principal--to become an interest slave. Under the cooperative bank plan there is an end to paying for the home and peace and comfort wait there.

Importance to the Individual.

Saving is effective only when it is for a definite purpose. To save, one must forego present satisfactions in the home that the satisfactions which will come in the future will be greater than the present. Many people seem to believe that there is at the present time an increasing preference for spending money on other types of consumption goods rather than on housing. This statement is open to question. Undoubtedly our people are buying many kinds of goods which were unheard of a few years ago. Probably these goods satisfy a demand which did not exist in that day. The difficulty is that most of these things are purchased out of current income with very little, if any, planning. The true incentives for effective saving include saving to buy or build a home, saving for an education, to establish a business, or to provide a "rainy-day" fund which will take care of emergencies.

The unmarried man may not be considering acquiring a home, but this may actually become one of the serious problems of his life if he has neglected to make some provision in his youth.

Home ownership has many comforting qualities that

promote a family's happiness, and this may quite outweigh all financial considerations. When a family is permanently located it becomes almost a necessity to own a home, regardless of cost. If there is no assurance of permanent employment on the other hand, of if the breadwinner of the family knows he must go elsewhere for employment within a year or so, house ownership may become a serious handicap. The family should carefully weigh the many advantages of living in their own home against the ease of moving from a rented house, if conditions should compel such a change.

Chapter 5

REAL ESTATE

History in the United States.[1]

George Washington, the first American millionaire is generally looked upon as our first subdivider, starting his successful real estate career with Lord Fairfax and his brother, Lawrence, in the planning and development of Alexandria, Virginia. He was later engaged in plotting sections and quarter sections, more along the lines of wholesaling, This was the first big step forward in the subdivision real estate business in America.

The second step forward was taken by William Elmer Harmon, who had the genius to conceive and the energy to apply the modern method of making it possible for people of limited means to purchase home sites on subdivisions on the easy payment plan.

Mr. Harmon created the system of giving a bond for a deed and in giving title only when the customary one-third of the total purchase price had been paid, the bond being subject to forfeit in case of default in the installment payments. The plan took like wildfire.

By his system, Mr. Harmon has made it possible for hundreds of thousands of people to own a part of the

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[1] The World Book -- vol. 10 -- p.6200

United States, who otherwise would find it impossible to do so.

Definition.

"Real estate is defined as any portion of the earth's surface, or anything in the nature of permanent construction, anything that is immovable. It not only includes land on the face of the earth but everything that is in it, over it, and under it. According to law, water is a species of land, because it covers it. It also includes meadows, pastures, heaths, marshes, minerals; anything growing on the land and any kind of structure, houses, fences, or any building or fixture which is not portable or movable is termed "Real Estate."

""When we speak of the real estate business, we are referring to those who take up the business of selling and acquiring for sale, real and personal property, lands, tenements, businesses of all description, renting, leasing, hereditaments, etc." [1]

Value as an Investment.

Real estate is a good investment because it affords the soundest security. Practically all stocks and bonds and other securities which are traded in on an investment basis, have their chief value represented in the real estate owned and controlled by the companies on which

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1. The Real Estate Guide -- J.F. Macdonald -- p.17

the stocks and bonds have been issued. Where would the bonds of the world's great railroads be without their realty holdings? Where would the securities of the great manufacturing enterprises be without their plants?

Land is imperishable. There is a fixed quantity of it, and as towns develop into cities, there comes an insistent demand for strategic sites for certain lines of retail business. Like no other commodity, real estate cannot be manufactured at will. All the usable land in the world is for sale, and everyone in the world is considered a potential purchaser.

Real estate furnishes an ample income if properly improved. It must be remembered that there are two definite elements of gain in real estate. It not only pays an income if the property is improved, but it also benefits by the steady increment in value which comes with growth in population.

"John Jacob Astor, when he went to New York in 1782, found a little city of 25,000 inhabitants. He cautiously began setting aside his surplus income for investments in real estate. He died leaving an estate worth twenty million dollars. His son, William Astor,

following in his father's footsteps, adding tract after tract of real estate to the family credit, increasing it until it was worth forty-five million dollars. John Jacob Astor 111, continued the family policy, and died leaving seventy-five million dollars. The Astor estate, and those who built it up, believed in buying property, and never selling it. As an example of the way Astor real estate grew in volume and value it is related that 150 acres of land were purchased near the Harlem River High bridge in 1883 for $300,000. A few years later, twenty acres of this land sold for $300,000 and $3,000,000 was refused for the remainder."[1.]

Real estate, if properly selected, enhances steadily in value. This point was brought out in the above illustration. If one has the foresight to look ahead and buy real estate in a town destined to become a city in the future, his fortune is made.

The safe and profitable investment of surplus funds always has been one of the puzzling problems of the business men of this country. Due to the ease with which stocks and bonds may be purchased in any denomination, much investing has taken this form. In the past, lack of knowledge of how to select and manage real

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1. How to Make Money in Real Estate -- S.L. McMichael -- p.24

estate has kept great masses of investment funds out of the real estate market. Within the past decade there has come into existence through the medium of real estate boards a new set of conditions. Trained realtors now stand ready to render service in assisting those who are attracted to realty investments.

Method of Investing.

The secret of profitable real estate investment lies in the application of knowledge of conditions to the buying of specific properties. This knowledge can be acquired only through intensive study. Printed matter on every subject relating to land and its development should be carefully read, so that a foundation may be laid for future operations.

Experience, we all know, is a great teacher. However, it is often too slow and too harsh an instructor. We should try to profit by the experience of others. In almost every community there is someone who has made a conspicuous success in the real estate field, and if it is possible to consult with such a person many valuable lessons may be learned.

The best way for the inexperienced to invest in real estate is to secure the assistance of a competent realtor, who makes such a business his life's work.

Types of Investment.

In a city there are many real estate opportunities. A profitable business is engaged in by persons buying old houses which are structurally sound, remodeling and modernizing them, installing new bathrooms and kitchen equipment, and then reselling at an advanced price.

Other investors will erect a two-family house, live in half of it until an opportunity comes to sell it, meanwhile collecting rental from the other flat. Such buildings meet with ready sale, and prove good investments for both builder and buyer.

Six-family apartments have been erected in large numbers in many cities. Such buildings should earn a good return on the money invested as the only expense in connection with such a property is providing front and rear hall lights, and the payment of taxes and repairs.

To the investor who has ample funds, the central business district of any growing city affords the greatest attraction. Here the largest fortunes in real estate are made.

Suburban land should be bought on main highways if possible. It may be used for a summer camp, an auto-

mobilists overnight camp ground, or a golf club, to help carry itself until the opportune time for selling comes.

Little farms may often prove good investments if they are bought and held until such a time as they can be subdivided for the erection of homes.

Summer resorts which have water facilities of some sort usually are good investments, especially when a subdivision is promoted in conjunction with them.

Money can also be made by investing in well located vacant lots. One must keep in mind however the idea of quick turnover, and because the market is rising rapidly, do not be hoodwinked into the idea that it will always continue to rise.

Owning Your Own Home.

Government statistics show that almost fifty per cent of the families in the United States own their homes. Doubtless many of the renters would also be home owners if they had the necessary savings to make their first cash payment. It would seem, therefore, that most of the people in the United States desire to own their homes.

This is as it should be, I believe, especially

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1. Fifteenth Census of the U.S. -- v.6, p.6 -- Table 2

for those who are trying to get ahead. Home owning promotes thrift because in most cases it compels systematic saving and offers the most tangible incentive for saving.

From the experience of many persons it is evident that rent is practically the costliest item today in all family living expenses; and if the purchase of a home will effect a material annual saving during the twenty or twenty-five years that are prospectively ahead of every family, it will certainly bring the day of financial independence nearer or yield a larger investment income when the contemplated age of retirement has been reached. It is perhaps the realization of this fact which prompts an increasing number of families to purchase homes in their early years.

A vital distinction between the payment of money toward the purchase of a home and the payment of rent is that the former is a high-class investment while the latter is no investment at all. The mistake of regarding rent as an investment arises from a rather loose grasp of the significance and meaning of money terms. Thus, rent is paid to a landlord as the price of shelter. It belongs on the expenditure side of a family budget.

On the other hand, money paid toward the purchase of a home represents both the cost of shelter and an investment. It belongs partly on the positive side of a family budget because it is made with two objects in view, namely, of paying the cost of shelter and of increasing the family income. To treat rent money as an income producer or as an investment is not only a confusion of thought, but it leads to fallacious reasoning. The two ideas are not reconcilable.

So far as a family's residence is concerned, the term "rent" signifies the cost of shelter. But when a couple is buying a home from savings instead of paying rent, the cost of shelter is summed up in interest on the price of the home, taxes, insurance, upkeep and other expense items which ownership always entails. If the latter cost of shelter is more economical than paying rent, the financial difference between the cost of shelter under owning and renting is the investment possibility afforded by home ownership.

The important question is, then, whether the cost of shelter is really cheaper with owning than with renting a home. Let me try to answer this question in the example below:

After renting a home for several years, Mr. Jones

tried buying a home in the firm belief that it would prove more economical than renting. For twenty years he and his family lived in that home at Kensington, Md. During the first five years he paid interest on the mortgage, at the end of which time it was paid off from savings, paid the taxes and insurance, and maintained the home in good condition. In comparison with a fair rental for such a property, the cost of shelter under owning as represented by these expenditures was approximately $60 a year less, or $300 for the five years. But for the next fifteen years the annual saving of $60 formed the nucleus of his financial independence fund and was invested each year at 6% compound interest. At the end of the period computation shows that it amounted to $1480 with the $300 saved during the first five years, his financial advantage from owning over renting a home totaled $1780.

As a matter of fact, however, when his goal of financial independence had been attained, the home was sold for $3400 more than he paid for it twenty years before. This was the unearned increment due to the rise in real estate values. Thus the savings in shelter cost and value of unearned increment totaled together $5180. The income from this sum at 6% a

year $310. To this extent, therefore, the payment of rent during those twenty years would not only have delayed his financial independence for the number of years it would have taken him to save that much money from annual income, but the actual savings from buying a home now yield him an income of $310 a year and will continue to do so as long as he keeps it invested at that rate of interest.[1]

Can I afford to own a home and how much can I afford to pay for it? This question is frequently asked by people who have the desire to buy a home, but who fear that an obligation of from $5000 to $10,000 is more than they can assume.

It is useless to try to set up arbitrary standards for determining the price that families, having a certain income, can afford to pay for a home, because of the fact that families having the same income may not be able to pay the same amount toward the purchase of a home. Besides, people's tastes and standards of living differ. Some prefer to spend more than the average for shelter and less for something else. Some authorities estimate that the value of one's home should be about two or two and one-half times one's annual income. According to this estimate a home

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[1] Magazine of Wall Street -- J.B. Morman -- p.42

costing $6000 could be bought on an income of from $2400 to $3000.

Others estimate that one can afford to spend about one-fourth of one's income for shelter. According to this estimate, a family whose income is $3000 a year could spend $750 for shelter and, since the annual rent of a home is about 12% of the value of that home, it would seem that a family having an income of $3000 could buy a home valued at $6250.[1]

The fact is that anyone who has saved, or can save, enough money to make a first cash payment, can afford to buy a home valued at about the same amount as a home he can afford to rent, provided that he can continue to save and reduce his mortgage.

For example, if a man is now paying $60 a month, or $720 a year, for rent, then the value of the home he is renting is about $6000, because the charge for rent averages about 12% of the value of the property. Since the rent charge is approximately the same as the carrying charge a man who is renting a $6000 home, can feel reasonably sure that he can pay the carrying charges on the same kind of a home.

If this man has saved at least $1500 and can use not less than $1200 of this amount to make a first payment

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[1] Spending the Family Income -- S. A. Donham -- p.36

on a home (holding the remaining $300 in reserve for emergencies) then he can borrow the balance, $4800, on first and second mortgages. If he can save about $400 a year, then he can pay off these mortgages in about twelve years.[1]

In other words, if you can afford your present rent charges, then you can also afford to pay the taxes, interest, insurance, and other carrying charges on a home valued at approximately the same as the one you are renting.

If you can save money, then you need not worry about a mortgage, because your savings can be used to pay off the mortgage. As a general rule, home buyers save more money than renters, because of the compulsory feature.

When you have decided that you can afford to buy a home and how much you can pay for it, do not be in a hurry and rush into the first proposition that is presented. Be cautious, compare values, seek competent advice, and engage a reputable lawyer to handle the necessary legal matters.

As a general rule, if a reliable, conservative, and well-established bank or building and loan association

[1] Simple Principles of Investment -- T. Gibson -- p.2

will take your mortgage, it is an assurance that your proposition is sound. The officers of these institutions are usually qualified to give excellent advice to home buyers.

Thus it may be seen that as soon as is practical after providing the funds described in the previous chapter, I advocate the purchase of a home, and this should not be in the too distant future for the average young man. It should most certainly be hastened, as the sooner it can be accomplished the smaller will be a person's accumulation of rent receipts, which are good for little, except making first class material with which to build fires.

Of course it must be understood that like all other investments there is an element of risk in buying a home or other real estate.

Chapter 6

STOCKS AND BONDS

Definition of Investment.

Before forming our definition we must make the distinction perfectly clear between investment and speculation. If a man wishes to buy an investment stock or an investment bond and pay for it in full, his desire to invest is apparent. On the other hand, if he wishes to purchase (or sell) an active security which is subject to wide and rapid fluctuations and open a margin account, it is equally clear that he wishes to speculate. As it is commonly expressed, he will either buy for investment or he will buy (or sell) for speculation. There is no vague and undefined line between these two transactions. Each is separate and distinct. With this in mind it should not be hard to form our definition.

Investment may be defined as the placing of money in securities (or other property) with the intention and reasonable expectation of receiving a regular return in the form of interest, dividends, or rent, and with the reasonable expectation that the principal will be

returned at a later date. This clearly distinguishes investment from speculation, where the expected gain is caused by the fluctuation of the principal; and the interest, dividends, or rent (if any) are a secondary consideration.

In this definition we have considered the intent of the purchaser and the risk of the security. In actual practice the intent of the purchaser is perfectly clear. He either wishes to obtain an income by investing his money or he wishes to increase his principal by speculation. Investors give much attention to intrinsic values and are only slightly interested in prices, while speculators give practically all their attention to market quotations and care very little about values.

The element of risk is not so well defined. We know the two extremes, but where shall we draw the line between them? We may say that when men of intelligence and discretion commonly invest in a certain security the purchaser of that security will be taking an investment risk. By the same criterion, the purchaser should diversify his investments and place only a small part of his fund in one security--especially when the risk is great.

Stocks versus Bonds.

The greater safety of bonds than stocks as a class is most strikingly shown in case of failure. When a company goes into receivership it often happens that the stock is entirely wiped out. While this sometimes occurs in the case of bonds, it is comparatively rare.

The holder of a corporation bond is a creditor, one who lends it money. The stockholders are the owners of the property.

The bondholder in return for his money receives a promise to pay, secured by a lien against the property of the company. He is in the position of any other lender of money on security. Naturally he expects to receive back his principal at maturity with specified interest, payments thereof coming to him regularly in the meantime.

The stockholder, however, as one of the owners expects to receive his share of all the profit which the corporation can legally disburse, and in addition, with the other stockholders, owns the property of the company, if there is any, after its debts are paid.

One very great merit of stocks over bonds in the case of large investors is the comparative freedom from taxation. That is of no concern as a rule to the small investor, that is, to the wage earner or salaried man who has only a few hundred or a few thousand dollars to invest. To the widow, however, who lives upon the income from a sum of $10,000 and upward, taxes may bear very heavily. Such a person should study carefully the possibilities of buying conservative stocks.

Another advantage which stocks enjoy over bonds is that it is easier to purchase them in small amounts. While there are a few small bonds, yet they are much rarer than small unit stocks.

In buying stocks it is always important to notice whether they are "non-assessable." In case of failure the owners of bank stocks may be forced to contribute large sums to pay the creditors. Oil and mining stocks are also sometimes assessable. Bonds of course never have any such disadvantage.

Types of Stocks.

Shares of stock represent part ownership in a business enterprise. The stockholder is never a

creditor, but always virtually a partner. The stockholder consciously and knowingly is supposed to assume the risks of enterprise. The corporation issuing stock sefves notice that it does not obligate itself in any way to pay dividends, the declaration and discontinuance of which remain matters entirely within the discretion of the board of directors whom the stockholders themselves choose to supervise the management.

There are two main classes of stocks—common and preferred. The dividend rate on preferred shares is usually fixed at definite rates, such as 5, 6, 7, or 8 per cent.

Directors must declare the full rate on the preferred stock before making any distribution on the common shares. However, except for priority over the common stock in respect to the payment of dividends and distribution of the assets of the corporation in case of liquidation, preferred shares are really junior securities on which nothing need be paid except at the will of the directors. They are subject to the prior claims as to assets and current distributions of all types of bonds of the corporation which may be outstanding.[1.]

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1. Principles of Investment -- J.E. Kirshman --p.207-210

Nothing is available for dividends on the common stock until interest on all the bonds of the corporation has been paid and until all dividend requirements on the preferred stock have been met. After all the prior charges have been taken care of, the residue of earnings is available for common stock. The directors have the option of paying out all or part of the residual earnings in the form of dividends or of holding them in the treasury of the corporation for surplus account. In case of slim earnings nothing is likely to be left for the common shareholders to compensate them for the use of their funds. However, in instances of an unusual success with extraordinarily large earnings, the common shareholders are the chief beneficiaries, for the bondholders and preferred stockholders get only their 4, 5, 6, 7, or 8 per cent, whereas the common shareholders can receive amounts limited only by the earning power of the corporation.

For the individual in quest primarily of safety of principal and assured regularity of income; common shares are the least attractive of any of the securities of a given corporation. On the other hand, for the speculator who knowingly accepts larger risks in the hope of huge profits, common shares are the most attractive of all

types of securities as a vehicle for attaining his hopes.

Though the bonds of a particular corporation are always safer than the stocks of the same enterprise, it by no means follows that all bonds are more secure than all stocks. As a matter of fact, the common stock of a well-established and successful enterprise often constitutes a better investment than an underlying first mortgage bond on an experimental, poorly managed industrial concern.

As a general rule, railroad earnings are not subject to violent fluctuations. Any large railroad system carries a number of important products and its earnings are comparatively even and dependable. This is an advantage for all railroad securities, including, of course, the preferred stock. On the other hand, railroad companies have large issues of bonds and notes, and for this reason the claim of the preferred stock is rather remote. Moreover, the large majority of railroad preferred stocks are non-cumulative and without this safeguard their dividends are more uncertain. The earnings of public utilities are also comparatively even and dependable, and their preferred stocks do not have the first claim on the income if there are

any bonds outstanding. Many of the preferred stocks issued by public utility companies are cumulative and this is, of course, a favorable feature.

It is seen from the foregoing paragraph that the preferred stocks of railroads and public utilities do not have a first claim, or anything like a first claim, on the income of the corporation, and they are not so well secured by earnings as the best industrial preferred stocks.

The common stock of industrial group is much more satisfactory for speculative purposes. As stated above railroad and public utility earnings are not subject to violent fluctuations. Therefore, if one has money for speculation he had better buy common stock of a good industrial concern.

Types of Bonds.[1]

Bonds ordinarily represent a promise of a corporation or a government to pay back a specific sum borrowed, at a specified date, and in the meantime to pay a stated rate of interest. The bondholder is always a creditor of the borrower. He relies on the promise to pay of the debtor corporation or government. If the borrower fails in any essential to live up to

[1] Principles of Bond Investment -- Chamberlain, Edwards
Parts 2, 3

its promises, the creditor can at once protect himself by throwing the corporation into receivership. In the case of a government, the bondholder however, must rely upon its good faith. If a borrower fails to pay interest on bonds, its lapse is known as a default, which constitutes a black mark against its reputation and may injure its credit irreparably.

Bonds issued by all forms of government are called civil loans. There is one characteristic of all such bonds that distinguishes them from all others: they are sustained, and ultimately retired, by the exercise of the power of taxation. They may have other forms of security common to other types of bonds, such as the direct pledge of the issuer, a lien on physical property or on intangible property, and a prior claim on certain revenues, but the ultimate security, the characteristic security of this class is the tax power.

Civil loans may be raised either to alleviate government deficits or to undertake public works. Deficits may be of a casual or an emergency nature. Revenues may unexpectedly diminish or expenses may increase beyond anticipation. A resulting deficit

may then be met by borrowing. Casual borrowing differs from an emergency indebtedness only in the urgency of the fiscal need. Emergency loans may be raised when a state is subjected to a calamitous flood, earthquake, war, or revolution.

Public works may be commercial or non-commercial. The erection of a power plant or the building of a railway from state funds would be the undertaking of a commercial public work. The construction of a court house or a school building would not add directly to the revenues of the state and would be classified as non-commercial in nature.

One outstanding advantage should be cited before leaving the subject of civil loans and that is: states and governments generally do not tax their own bonds.

Corporation loans may be subdivided into transportation, public service and industrial loans. Railroad securities, of a good line, offer the most stable and certain security possible except for the civil loans. Steamship bonds naturally find a place among the loans of transportation companies although they have no prominence as a type of security.

The usual list of public utility enterprises

consists of so-called franchise corporations, such as electric light and power, hydro-electric, and electric traction corporation, gas companies, water supply companies, and telephone and telegraph companies. The bonds of these companies are usually good because of the stability of the gross revenues of utilities.

The general term industrial securities applies to all issues not classed as government, municipal, railroad, public utility, or real estate. Each industrial company should be judged by its own particular standards.

As a group industrial issues are unseasoned and should not, therefore, be regarded as high-grade investment. For this reason and for the additional fact that industrial enterprises are subject to wide fluctuations in earnings, there has developed against them a prejudice that will require a long time to overcome.

Because of the inherent risks of the industry, together with the long-standing prejudice on the part of conservative bankers and investors, industrial bonds of merit equal with railroad and public utility issues almost invariably sell on a higher yield basis. The investor who is qualified to investigate might do well, therefore, to examine the better grade of industrial

issues.

Method of Investing.

A big subject is investment and yet one of which a working understanding is not difficult to acquire. Knowledge of the different kinds of securities and their main attributes--that is, of course, the very first thing. After that appreciation of the main investment principles--of the desirability, for example, of diversifying an investment, and of the relative importance of such qualities as marketability, price stability and chance of appreciation in value. Thirdly, at least a general idea of what makes security prices go up and down--of the bearing, on bonds and shares, of business and money-market conditions and the other main influencing factors. Informed along these three lines, and using a reasonable amount of common sense, the man or woman with money to invest is not going far wrong.[1]

There are several desirable ways of diversifying an investment--a combination of which might well be considered an ideal toward which the investor should aim.

They are as follows:

1. Various types of securities may be chosen.

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[1] Simple Principles of Investments -- T.Gibson --p.2

a. Common stock.
b. Preferred stock.
c. Bonds.

2. Securities may be purchased in the various fields.

a. Railroad.
b. Public Utility.
c. Industrial.

3. Securities may be chosen having interest or dividend payments come due at different times.[1]

One might immediately think upon glancing at the above outline that such a plan was impracticable, involving more work than the results justify. The plan can, in fact, be carried to a point that is impracticable. If a person diversifies out of all proportion he will own so many securities that it would be an impossibility to watch them with the necessary care.

Diversification carried on in a logical manner is, however, a virtual requisite if one may be said to be investing along sound lines.

1. Careful attention should be given to the character of the individuals or financial groups controlling properties in which investments are contemplated.

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[1] Practical Investing -- F. Escher -- p.3

2. The records of past earnings, dividends, etc., should be examined over as long a period of time as possible.
3. Changes in control should be noted and investigated.
4. While both equations should be considered, the average investor is justified in giving more attention to earning capacity and income return than to so-called property value.
5. Prejudice against certain classes of stocks or bonds should be eliminated and each proposition weighed on its own merits.
6. Intelligent consideration of the future of any enterprise is vastly more important than the known conditions of the present or the records of the past.[1]

I believe the above rules are listed in the order of their importance. Management must be sound and of a high degree if a concern is to be successful. Poor buying policies alone could put an otherwise ideal concern in a very serious condition--in a condition that would make highly speculative any securities which it might offer. Thus one should note carefully the type

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[1] Practical Investing -- F. Escher -- p.3

of management in a concern where investment is contemplated, being particularly careful to note whether any important managerial changes have taken place since the publishing of the last financial report. Should any such changes have taken place, other things being equal, the securities should certainly be looked at from rather a speculative angle.

If the management remains intact, past earnings may be looked upon as rather a test of the successfulness of the management. Thus this point is really sort of a supplement to the above one.

Obviously if one is to select securities which will appreciate as rapidly as sound investments may be expected to, he must consider future conditions. It is probable that such industries as the airplane industry, for example, will prove more than ordinarily successful in the future--thus the securities of companies in this field would prove more than ordinarily attractive to the investor studying the future earnings of industries with a view to investing. [1.]

The following is an entirely original list of factors which, I believe, one might well consider previous to investing in any security:

1. Is the company in question in a basic industry?

[1.] Simple Principles of Investment -- T. Gibson -- p.22

If so, such a fact would certainly tend to be a stabilizing factor——a factor minimizing the risk element, which is present to some extent in all securities.

2. Does the industry offer chances for future expansion? This too is important, for there are so many companies offering this advantage that if one does not take it into consideration when purchasing securities, he will in a sense be penalizing himself as his return, if he selects the security of some company not enjoying this prospect, in dividends or interest must be sufficiently high to offset the disadvantage of the absence of this highly desirable factor.
3. What position does the company occupy in its industry? If a company is not the dominant factor in its industry it should be thoroughly understood that its business policies must conform to a great extent to those of its larger competitor. It should also be realized, that any company in an industry, dominated by some powerful company, is subject to any price cutting or other forms of pressure which the dominant factor in the industry cares to exer-

cise.

4. The ratio of current assets to current liabilities may always be considered with a view to determining average over a period of years as well as stability.
5. The past record of the company should be considered. Has its growth been as rapid and yet at the same time as conservative as could reasonably be expected?
6. The management of the company should be very carefully considered because, as I have pointed out above, without high grade management a company cannot hope to attain even reasonable success.
7. The manner in which a company maintains its physical properties is also worthy of note--particularly so if the security in question is a bond.
8. Has the company in question an adequate equity in assets to cover the stock under consideration? I should say this is a vital point as if the company has not such an equity it certainly is worthy of no further consideration from an investment viewpoint.
9. Has the company in question an adequate equity in earnings? I should say that, as in the point

regarding equity in assets above mentioned, lack of such equity would be sufficient cause for removing the security from the investment group.

10. Has the company a large surplus which is available for distribution either in cash or stock to stockholders? Any company possessing such a surplus may be said to be a particularly attractive investment--particularly so if the stock market has not fully discounted the large surplus accumulation.

11. The past stock market performance of the shares under consideration should also be carefully noted. I believe, that the stock market is one of the most impartial judges of values over a period of years that one can find. Thus, if a stock has performed steadily and well over a period of years, it is a pretty good indication that the security is at least worthy of consideration.

12. The ratings of Moody are certainly worthy of consideration. Published by authorities, making a business of analyzing securities, it seems that the opinions expressed in this manual should

be of more than passing importance. Certainly any security given an "A" rating by such a reliable service has at least interesting possibilities.

13. The raw material reserves possessed by a company are in many instances worthy of note. One of the really big factors tending to make the position of the U. S. Steel Company so impregnable is its large reserves of raw materials.

14. Then, finally, has the company under consideration diversity of output? That such a condition is highly desirable is indisputable.

More than likely you will be thinking that such a list as I have just presented is impracticable because of its length. I do not agree with you if you do entertain thoughts along that line. In my financial layout presented in this thesis I placed securities last for the following reasons:

1. I think that to be happy in the knowledge that one's wife and children are adequately provided for in case of accident should be every man's ambition, and I do not see how this can be accomplished in any better, surer way than the

one suggested, and this necessitates securities being considered only after the other provisions outlined have been made.

2. I do believe there is a very considerable element of risk to be combated when investing in securities.

It is this second point that leads me to believe that the above list, of which I am more or less proud, is not unduly long. It is hard work to earn and save money; thus, when once money is accumulated, should one protest if it is necessary to go to some trouble and work to be sure it is safely invested? I think not. Better a little additional work than loss of money, through careless investment, the saving of which represented so many hours of work and planning.

Finally, one should not invest in securities until he fully realizes the existence of, and understands the operation of, the converse movement of security prices. Investment policy should not be based on the assumption that stock and bond prices always move in parallel. Indeed, the opposite tendency is shown. During certain periods, both may move together as low interest rates make for high bond prices and also encourage speculative

purchasing of stocks. But since the causative factor operating directly to affect stock prices, that is, corporate earnings, differs radically from that influencing bond prices, that is, relative interest rates--since large corporate earnings tend to make stock prices rise and since the concomitant, high interest rates, tends to make bond prices fall--over any extended period the movement of stock prices will be converse to that of bond prices rather than in parallel.[1]

The facts so well stated above are indisputable and must be thoroughly understood. Such facts mean that in a period of prosperity money will be scarce and thus concerns issuing bonds at this moment will of necessity have to offer a yield on the bonds sufficient to attract the desired amount of investment funds. Thus, just at this juncture is the opportune moment to sell stocks, which will be at a high level and purchase bonds which will be offering an attractive yield.

Then, to move on to a period of depression, we find funds plentiful and cheap. So that the prices of the bonds purchased during the period of prosperity above mentioned, and enjoying high interest returns, will advance considerably. This, then, is the time to sell

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[1] Investments -- D.F. Jordan -- p.233

bonds and purchase the stocks of sound companies, stocks which measure up to a majority of the requisites mentioned above, which will at this time be selling at a low figure, owing to the depression which, of course, has cut heavily into corporate earnings, which may be truly said to be a mighty factor governing stock prices.

Thus it may be said that the investor should no more buy stocks in the expansion stage of the cycle than he should buy bonds in the depression stage. Nor is there economic justification for selling bonds in the expansion stage. The most advantageous times to buy and sell have been indicated. An investor may scarcely be called a speculator if he attempts to take advantage of such opportunities when he desires either to purchase or sell securities.[1.]

To sum up the investment policy which best suits my plan then I may say that before buying a security I am convinced of the advantage of diversification carried on in a logical manner. When I have accumulated funds to invest in securities I shall make careful investigations before investing in any specific security as I am convinced time spent in this manner will not be time wasted. Finally, before purchasing any

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1. Investments -- D.F. Jordan -- p.233

securities I will determine whether or not it is a logical period in the business cycle to purchase the securities under consideration.

Making my investments in the above outlined manner I do believe I have eliminated a great portion of the risk element--at the same time I believe as previously stated that risk remains in sufficient quantities to justify one investing in securities only after he has made provisions similar to those I suggest--savings bank, life insurance, home.

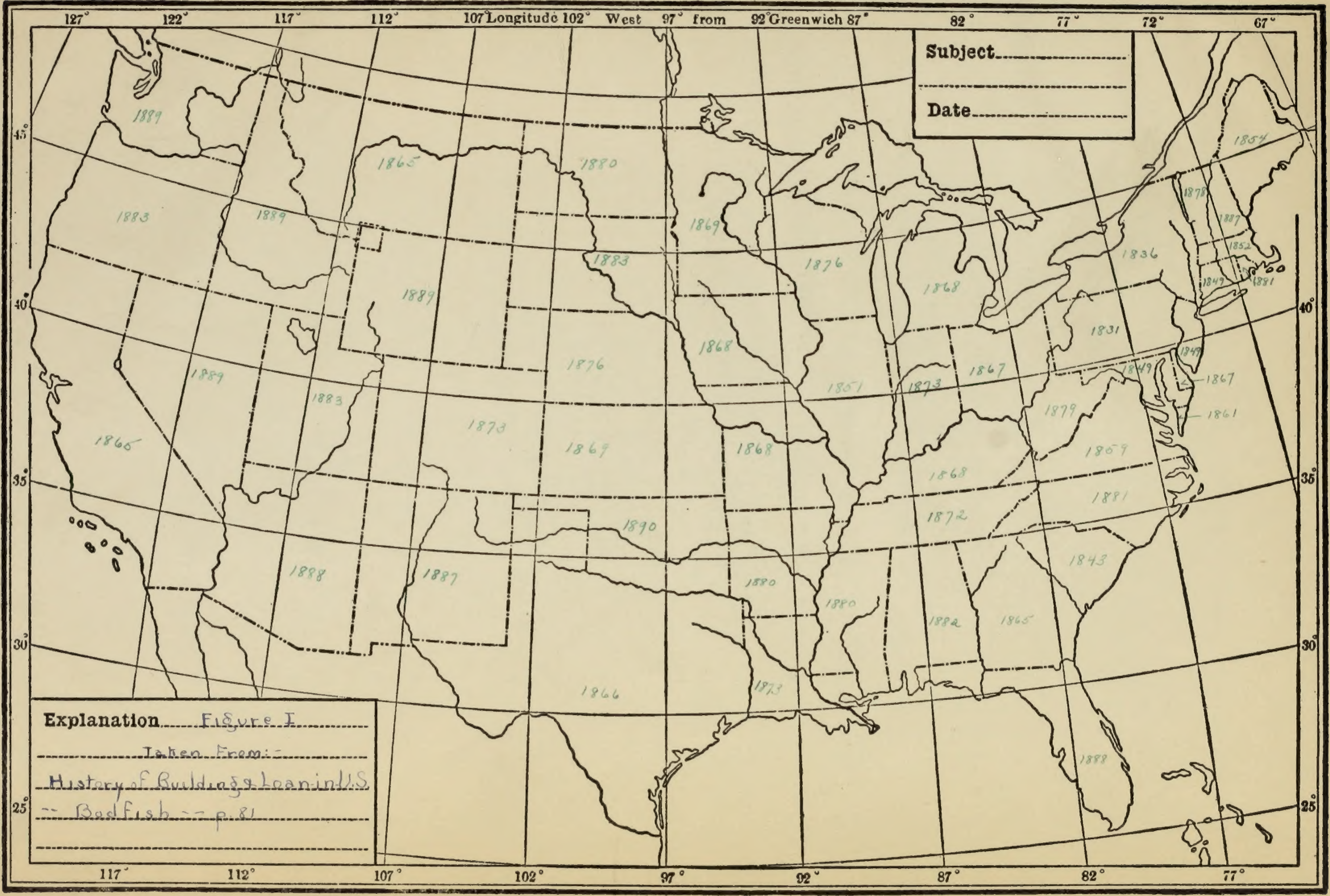
Chapter 7

CONCLUSION

In concluding this thesis I wish to say that the above is not the only way one may successfully prepare for old age, although I do believe it is as good as any. Obviously substitutions could be made to suit the individual--the "rainy-day" fund might be kept in some other way than in the savings bank, the types of life insurance might be shifted and countless other alternatives could be found for investing surplus funds than the securities and real estate plans offered. This is all realized and yet the putting of these ideas, which I have been taught since youth by an able, wise and successful father, in writing has only served to repeat my opinion that this is the best method. It will be mine, and I will be--oh, well, ask me if I still advocate it fifty years from now and I will answer, what?

Date of the First Building and Loan Activity in each State

McKinley's Geographical and Historical Outline Maps. No. 176b. The United States. (State boundaries.)


127°
122°
117°
112°
107° Longitude 102° West 97° from 92° Greenwich 87°
82°
77°
72°
67°
45°
40°
35°
30°
25°
Subject
Date
1889
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1865
1866
1873
1888
117°
112°
107°
102°
97°
92°
87°
82°
77°

Explanation Figure I

Taken From:-

History of Building & Loan in U.S

-- Bodfish -- p. 81

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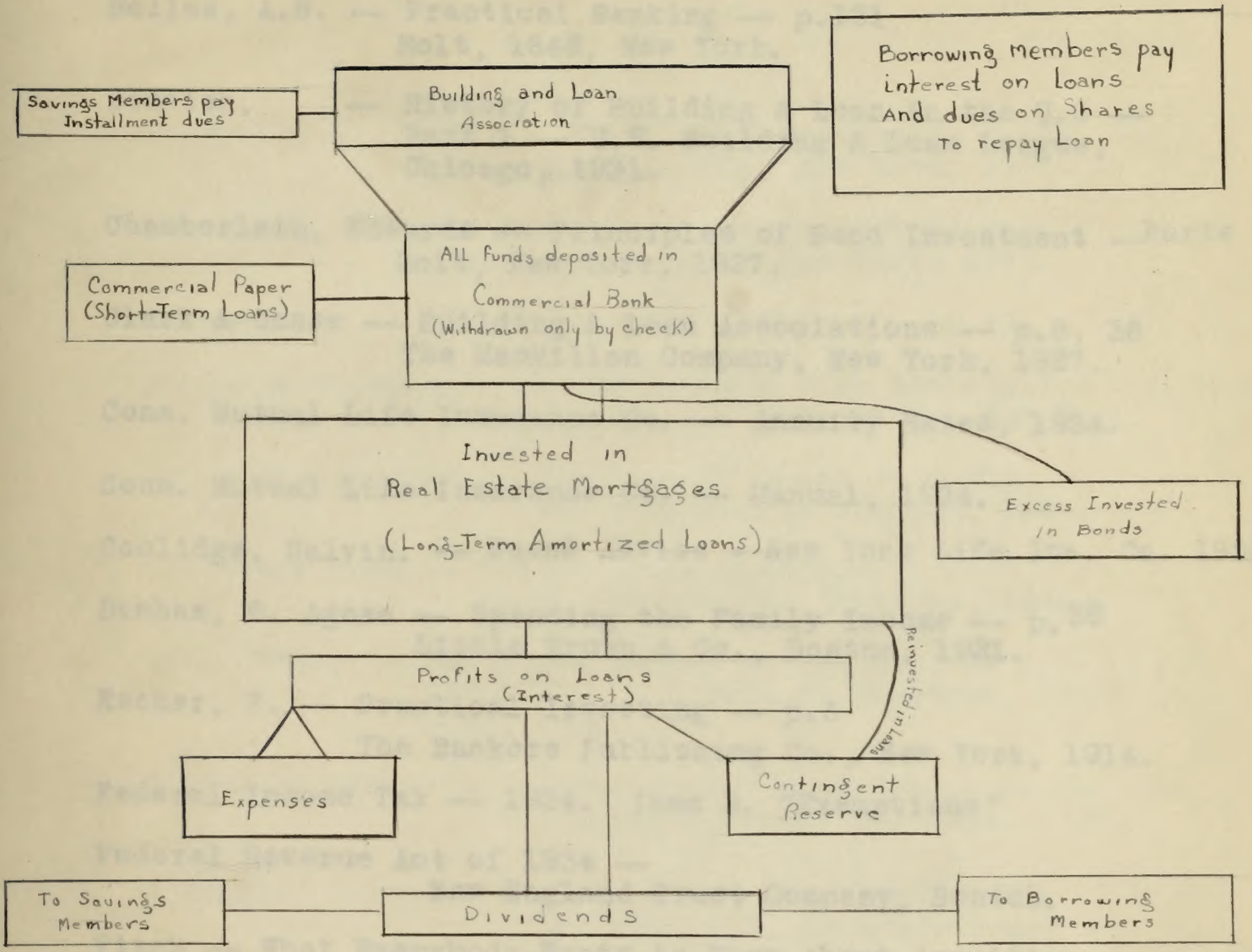
Savings Members pay Installment dues
Building and Loan Association
Borrowing members pay interest on Loans And dues on Shares To repay Loan
All funds deposited in Commercial Bank (Withdrawn only by check)
Commercial Paper (Short-Term Loans)
Invested in Real Estate Mortgages (Long-Term Amortized Loans)
Excess Invested in Bonds
Reinvested in Loans
Profits on Loans (Interest)
Expenses
Contingent Reserve
To Savings Members
Dividends
To Borrowing Members

General Plan of Operation
OF A MODERN
Building and Loan Association

Figure 2

Taken from: Building and Loan Association -- Clark & Chase-- p.8

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